FILE COPY

JUL 18 1944
CHARLES ELMORE CROPLEY

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 137.

PRUDENCE REALIZATION CORPORATION,
Petitioner,

—v.—

JOSEPH W. FERRIS, GEORGE L. LONG and HENRY LEIFERT as Trustees under a Declaration of Trust dated as of July 1st, 1938, with respect to 307 West 36th Street (Burnside) First Mortgage Participation Certificates, CITY BANK FARMERS TRUST COMPANY and MARTIN S. LINDGROVE as Trustees under the Last Will and Testament of HERMAN STUTZER, deceased, on behalf of themselves and other holders of certificates in 307 West 36th Street (Burnside) First Mortgage Participation Certificates, SOLOMON ZAUDERER, MILTON KIMMELMAN, IRVING ZAUDERER and CHARLES KIMMELMAN, doing business as KIMMELMAN AND ZAUDERER, on behalf of themselves and all other holders of Prudence Bonds Corporation participating certificate issue, and HUNTER L. DELATOUR, RAYMOND REISLER and JEROME THRALLS, Trustees of REALTY ASSOCIATES SECURITIES CORPORATION, debtor, holders of Burnside Certificates,
Respondents.

BRIEF FOR RESPONDENTS JOSEPH W. FERRIS, HENRY LEIFERT AND GEORGE L. LONG AS TRUSTEES UNDER A DECLARATION OF TRUST DATED AS OF JULY 1, 1938, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

CHARLES H. KRIGER,
Counsel for Respondents
Joseph W. Ferris, etc.

HENRIETTA KRIGER,
Of Counsel.

ALPERT PRESS, BROOKLYN, N. Y., TEL. TRIANGLE 5-1058-1059

INDEX.

Subject Matter	PAGE
The Opinions of the Courts Below	2
Statement	2
What the Court of Appeals Decided	2
Questions Stated to be Presented	4
Argument	
Point A	4
Conclusion	11

TABLE OF CASES CITED.

Chicot County Drainage District v. Baxter State Bank, 308 U. S. 371	10
Foust v. Munson S.S. Lines, 299 U. S. 77	8
Hewit v. Berlin Machine Works, 194 U. S. 296	5
Prudence Realization Corporation v. Geist, 316 U. S. 89	4
Security Warehousing Co. v. Hand, 206 U. S. 415	5, 6
Sherman v. Buckley, 119 F. 2, 280	8
Thompson v. Magnolia Co., 309 U. S. 478	8

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 137.

PRUDENCE REALIZATION CORPORATION,
Petitioner,

—v.—

JOSEPH W. FERRIS, GEORGE L. LONG and HENRY LEIFERT as Trustees under a Declaration of Trust dated as of July 1st, 1938, with respect to 307 West 36th Street (Burnside) First Mortgage Participation Certificates, CITY BANK FARMERS TRUST COMPANY and MARTIN S. LINDGROVE as Trustees under the Last Will and Testament of HERMAN STUTZER, deceased, on behalf of themselves and other holders of certificates in 307 West 36th Street (Burnside) First Mortgage Participation Certificates, SOLOMON ZAUDERER, MILTON KIMMELMAN, IRVING ZAUDERER and CHARLES KIMMELMAN, doing business as KIMMELMAN AND ZAUDERER, on behalf of themselves and all other holders of Prudence Bonds Corporation participating certificate issue, and HUNTER L. DELATOUR, RAYMOND REISLER and JEROME THRALLS, Trustees of REALTY ASSOCIATES SECURITIES CORPORATION, debtor, holders of Burnside Certificates,

Respondents.

BRIEF FOR RESPONDENTS JOSEPH W. FERRIS, HENRY LEIFERT AND GEORGE L. LONG AS TRUSTEES UNDER A DECLARATION OF TRUST DATED AS OF JULY 1, 1938, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

I.

THE OPINIONS OF THE COURTS BELOW.

The opinion in the Supreme Court is unreported (R. 322).

The opinion in the Appellate Division is reported at 266 App. Div. 543 (R. 340).

The opinion in the Court of Appeals is reported at 292 N. Y. 210 (R. 359).

II.

STATEMENT.

The petitioner has filed a petition for writ of certiorari to review the judgment and order of the Court of Appeals of the State of New York, and the judgment entered in the office of the Clerk of the Supreme Court of the State of New York, County of New York thereon. The action is one by your respondents for a declaratory judgment declaring the rights of the petitioner and other certificate holders in a mortgage on real property covering premises 307 W. 36th Street in the City, County and State of New York, which mortgage is referred to as the Burnside mortgage.

III.

WHAT THE COURT OF APPEALS DECIDED.

The New York Court of Appeals unanimously held that the certificates held by the petitioner are subordinate to those held by others in an opinion printed on page 359 of the record, and reported at 292 N. Y. 210. It decided:

First: That the Burnside Plan of Reorganization did not define or determine the rights of the parties nor were such rights determined by the Bankruptcy Court in the course of its administration or in connection with the distribution of any of the assets of either Prudence or Amalgamated;

Second: That where neither a Plan of Reorganization nor any order in the proceedings undertakes to modify the legal rights of the parties, that such rights remain as they were before the institution of the bankruptcy proceeding.

We quote from the opinion of the Court of Appeals as follows, page 336 of the Record (292 N. Y. 210, at page 218):

> "Upon this record it appears without contradiction that the Burnside plan of reorganization did not attempt to define or determine the relative rights of Realization Corporation as the holder of certificates acquired by Prudence and of other holders of Burnside certificates, nor was any determination of these rights made in the Bankruptcy Court in the course of its administration or in connection with the distribution of any of the assets either of Prudence or of Amalgamated. The controversy, therefore, was brought to the State courts, as contemplated by the plan of reorganization for determination of these relative rights unaffected by the reorganization consummated in the Federal court.
>
> "Corporate reorganization in the Federal courts is a process of adjustment and modification of legal rights frequently involving the impairment of contractual obligations under plans predicated upon the consent of security holders and creditors and upon the court's approval of the plan as fair and equitable and therefore binding upon the minority. If neither the plan nor any order in the proceeding undertakes to modify the legal rights but leaves those rights to be determined by courts of competent jurisdiction, such courts have no power to impair the legal or equitable rights of the parties. The court below erroneously regarded the *Geist* case as establishing a rule. It was only effective in determining a question affecting the administration and distribution of assets in the particular reorganization before the court. To conclude that our decision is ruled by the decision of the Supreme Court in the *Geist* case, we should have to modify the Burnside plan of reorganization, which did not undertake to determine, define or modify the relative rights of certificate holders under the Burnside mortgage."

IV.

QUESTIONS STATED TO BE PRESENTED.

In substance, the petitioner claims that the question presented is whether the State court disregarded provisions of the Bankruptcy Act and the decisions of this Court in determining the issues presented.

ARGUMENT.

POINT A.

NO FEDERAL QUESTION OF SUBSTANCE IS PRESENTED.

No claim is made in this case by the petitioner that the Plan of Reorganization of either Burnside or Prudence, nor any order in either proceeding accorded the petitioner parity. That, as stated by the Court of Appeals, appears without contradiction. What petitioner urges in effect is, that because this Court in a similar proceeding, *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, accorded it parity, it is entitled to parity here as well. This contention is entirely without substance.

Let us briefly examine the facts. The Prudence Company, Inc., the predecessor in title of petitioner, issued mortgage participation certificates, which it guaranteed, to various certificate holders. The mortgage originally in the sum of $1,200,000 had been reduced to $1,016,000 (R. 248, 249). The petitioner holds $431,212.86 in certificates (R. 249). The bond and mortgage by its terms became due on July 1, 1932 and all certificates matured on that day (R. 130). The previous owner of the premises had defaulted in an installment of principal due January, 1932, and Prudence had caused the property to be acquired by its subsidiary Amalgamated Properties, Inc. in June, 1932 (R. 20, 130). Under the terms of the guarantee, Prudence had eighteen months from July 1, 1932 to make payments of principal (R. 51).

On February 1, 1935, The Prudence Company, Inc. filed its petition in the Bankruptcy Court. On March 16, 1936, Amalgamated Properties, Inc. as owners of the property filed a petition for reorganization as part of the then pending reorganization of The Prudence Company, Inc. (R. 181). Thereafter, and on April 22, 1938, an order was made severing the proceedings and the proceedings of Amalgamated Properties, Inc. thereafter continued separate and apart from that of The Prudence Company, Inc. (R. 321).

Had the question of the relative rights of Prudence and other certificate holders in the mortgage been presented prior to the filing of any bankruptcy proceedings, there is no question but that a determination of the question of parity would have been made according to the law of the State of New York. The rule would have been the same whether the action was in a State or Federal Court, for it is in the State of New York that the land is situated, and the bond and mortgage, the participation certificates and the agreement of guarantee were made and delivered. Had such a determination been made at that time, this Court would have no concern with the decision whatever it was. The issues involved would be purely of State law and by no stretch of the imagination could any Federal question be involved. What the Court of Appeals held here, was that the Bankruptcy Court did not determine, define or modify the rights of certificate holders either by the plan or reorganization or by any order and hence that the rights of certificate holders are what they were before the filing of the petition and are unaffected by the bankruptcy proceeding. This statement of law is unassailable.

The filing of a petition in bankruptcy does not of itself alter the existing rights of parties. A trustee in bankruptcy has no better title than that which the bankrupt had.

Hewit v. *Berlin Machine Works*, 194 U. S. 296;
Security Warehousing Co. v. *Hand*, 206 U. S. 415.

In the case of *Security Warehousing Co.* v. *Hand*, this Court said at page 423:

> "It is no new doctrine that the assignee or trustee in bankruptcy stands in the shoes of the bankrupt, and that the property in his hands, unless otherwise provided in the Bankruptcy Act, is subject to all of the equities impressed upon it in the hands of the bankrupt."

No provision of bankruptcy law has been pointed out and none can be pointed out which provides that a right of priority in property of a creditor is lost through the mere institution of a proceeding in bankruptcy.

It is not necessary in this case to determine how far the Bankruptcy Court may go in disregarding rights claimed under State law. We shall assume for the purposes of this argument that the Bankruptcy Court could have deprived certificate holders of their superior rights under the State law, but it did not do so. Neither in the Plan of Reorganization of Burnside nor of Prudence was any determination made of the relative rights of Prudence and others in Burnside certificates. That fact is undisputed. The Plan of Reorganization relating to Burnside did no more than to recognize that a question had arisen as to the relative rights of the parties and reserved decision of that issue for determination by a Court of competent jurisdiction. This provision was part of the plan as amended (R. 175). The Prudence plan did no more than to recognize the existence of an undetermined parity issue (R. 84).

The main argument of the petitioner here is based upon a similarity of the reservation of decision of the parity question in this case with language used in a similar reservation in the *Geist* case. It should be noted, however, that the reservation in this case was part and parcel of the Plan of Reorganization, whereas the reservation in the *Geist* case was only contained in the order of confirmation.

Petitioner argues that the two reservations mean the same, and what they actually mean is that the question is reserved

for decision by a court of competent jurisdiction, but then only in accordance with bankruptcy rules of distribution. This statement is wholly unsupported by anything in the record, as is petitioner's statement that the only purpose of reserving the decision was to avoid delay.

The plan as originally promulgated provided for parity of all certificates. The amended plan says that a question has arisen as to the relative rights of the parties. That question was whether or not other certificate holders enjoyed superiority over Prudence, the guarantor. Unless they claimed that superiority under State law, no question would have arisen. No one claimed that the Bankruptcy Act subordinated Prudence. If it were thought that the question involved was whether there were any rights of priority under the bankruptcy law, why did not the Bankruptcy Court retain exclusive jurisdiction to determine the question? The question here was a very important one. Out of a total of $1,016,000 worth of certificates, a claim was made that $431,[illegible]12.86 was subordinate. It is inconceivable that the Court in its desire for haste would leave so vital a question open, unless it was intended that the decision to be made was one involving State law more properly determinable by a State court. The parties have by a practical construction interpreted the plan as requiring decision by a State court under State law. The petitioner here at no time sought an adjudication in the bankruptcy proceeding. It was as free as the respondent to seek an adjudication of the issue. Its failure to seek that adjudication in the Bankruptcy Court indicates clearly its interpretation of the meaning of the reservation. The reservation of the question for a decision by a court of competent jurisdiction meant a State court and could mean nothing else. Bankruptcy Courts do not refer to State courts' questions involving bankruptcy law. While proceedings are pending, the bankruptcy's jurisdiction of all questions is exclusive. However, the Bankruptcy Court can and often does consent that the interest of parties in property within the

jurisdiction of the Bankruptcy Court be adjudicated by a State court either because of convenience or what is thought to be unsettled State law.

Sherman v. *Buckley*, 119 F. 2, 280;
Foust v. *Munson S.S. Lines*, 299 U. S. 77;
Thompson v. *Magnolia Co.*, 309 U. S. 478.

If the Bankruptcy Court thought the question was one of bankruptcy distribution, it could have decided the question either before or after the confirmation of the plan so long as jurisdiction was retained. The only reason for giving jurisdiction to a State court is so that the rights of the parties would not "by the accident of federal jurisdiction—been determined contrary to the law of the state which in such matters is supreme." *Thompson* v. *Magnolia Co., supra* (309 U. S. 478, p. 483).

We are fortified in this view by the fact that the rights of the parties are not left solely to determination by the Court. The provision containing the reservation provides that in the event Prudence certificates are subordinate, that one-half the interest which would have gone to Prudence shall be paid as interest, and the other half put into the sinking fund for the retirement of certificates (R. 175, 176). This is an agreement by the parties to treat Prudence more favorably than it would be entitled to be treated if it were in fact subordinate, because in that event, it would not be entitled to have part of the interest moneys used to retire certificates.

The *Geist* case is not the same as the one here. There, the trustee commenced a proceeding while the bankruptcy proceedings were still alive, by an application in the Bankruptcy Court for a determination of the issue, and the Court reserved full and complete jurisdiction over that application at all times. Whatever the parties may have intended by the reservation, there is no question but that the Bankruptcy Court, while proceedings are still open, have full control over the plan and may modify and change it. This Court in its consideration of the *Geist* case treated the question presented as one of distribution in a bankruptcy proceeding. In

its language, it mentions the requirement of the Bankruptcy Act, that a Plan of Reorganization must be one which "is fair and equitable and does not discriminate unfairly in the case of any class or creditors", and that "dividends of any equal percent" shall be made "in all allowed claims except such as have priority or are secured". It talks about "the claim of Prudence" and of the impropriety of the "denial of the right to prove its claim". It states "allowance of The Prudence Company's claim does not involve any breach of its debts as guarantor". It treats the question purely as if presented on the propriety of approving a plan of reorganization and determined that such a plan cannot be approved unless parity is accorded Prudence. What this Court decided in the *Geist* case is succinctly and accurately stated in the headnote of the official report. It is in substance, that an insolvent defaulting guarantor of mortgage participation certificates is entitled to share *pro rata* in the distribution of the proceeds of the mortgage in a 77B reorganization proceeding; that the New York rule that the guarantor impliedly agrees to subordinate his own claim, is taken as a rule of State law governing State liquidation and is not applicable to bankruptcy proceedings; and lastly, that the Bankruptcy Act prescribes its own criteria for distribution to creditors.

The petitioner urges that the rule enunciated in the *Geist* case must be read into the Burnside Plan of Reorganization. In effect, what he says is that if it had been urged before the confirmation of the plan, that the plan would not be fair and equitable unless Prudence were accorded parity, then, parity would be ordered, and therefore we must assume that parity was accorded. This flies in the face of the fact that the plan actually was silent on the question of parity and does not more than say that the issue exists. Petitioner seeks to write into the plan a provision not there contained. It seeks to give this Court, in a collateral proceeding, the right to review the provisions of the plan in the light not of what has actually been done, but what petitioner says should have been done. If such a course is to be permitted, no plan of reorganization will be free from the possible attack that its provi-

sions are not fair and equitable, and in accordance with bankruptcy rules of distribution, and it will destroy the binding force of the doctrine of *res adjudicata* and open endless avenues for attacking reorganization plans.

A plan as confirmed, is not open to collateral attack. An order confirming a plan of reorganization is *res adjudicata*.

Chicot County Drainage District v. *Baxter State Bank*, 308 U. S. 371.

The *Chicot County* case was a suit on a bond issued by the Chicot County Drainage District which had been reorganized under the Municipal Debt Readjustments Act of 1934. The act under which the petitioner had been reorganized was subsequently declared to be unconstitutional by the Supreme Court of the United States. Nevertheless, this Court held that the decree approving the plan was *res adjudicata* and that it could not be collaterally attacked. There, this Court said at page 378:

> "The remaining question is simply whether respondents, having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined, were privileged to remain quiet and raise it in a subsequent suit. Such a view is contrary to the well settled principle that *res judicata* may be pleaded as a bar, not only as respects matters actually presented to sustain or defeat the right asserted in the earlier proceeding 'but also as respects any other available matter which might have been presented to that end.'"

The purpose of reorganization is to permit an insolvent concern to carry on. To this end, the act permits the modification and alteration of the rights of creditors. The manner and degree in which the rights of creditors are affected is determined by a plan approved by the requisite number of creditors affected by it and confirmed by the Court. Creditors whose rights are said not to be materially and adversely affected by the plan, need not approve (Section 77B, subdivision b). It is the plan when approved and confirmed

which determines the rights of creditors. All plans of reorganization are not alike. The two plans of reorganization involved in these proceedings, namely, the plan of reorganization involved in the Burnside issue and that involving Prudence, itself, are different. They are by necessity different because the problems involved in each reorganization are different. The Prudence plan and its order of confirmation occupies sixty-two pages in the Record on Appeal (from page 64 to page 126); the plan of reorganization and order of confirmation of the Burnside issue occupies forty-three pages on the Record on Appeal (from page 135 to page 177).

It is to the plans and orders of the Bankruptcy Court to which we must look in order to determine the manner and extent of the modification or change in the rights of parties. After confirmation, the plain language of the plan is controlling, and here, it is plain that the parties intended that their rights should be what they were before the proceedings were instituted.

CONCLUSION.

The Court of Appeals of the State of New York has not denied to the petitioner the benefit of any Federal statutes. The decision here is in accord with the provisions of the plan and the Bankruptcy Law. The petition for certiorari should be denied.

Respectfully submitted,

CHARLES H. KRIGER,
Counsel for Respondents
Joseph W. Ferris, etc.

HENRIETTA KRIGER,
Of Counsel.